

Pyramid Scheme Prevention

BUSINESS & LABOR

EXHIBIT NO. 5
DATE 1/11/13
BILL NO. SB20

SB 20 · Partnering with Industry to Stop Fraud

Montanans have lost millions in pyramid schemes

Last year, a nation-wide pyramid scheme known as ZeekRewards collapsed, costing 1,200 Montana participants more than \$3 million. Within weeks of the Securities and Exchange Commission's order shutting down ZeekRewards, new complaints started flowing into the Commissioner of Securities' office about a company with a nearly identical setup.

Pyramid Schemes are a Growing Problem

Unfortunately, pyramid schemes are all too common in Montana. Like all investment scams, pyramid schemes rely on trust, and scammers and con-artists have shown they stop at nothing to exploit Montanans' trusting nature. The office of the Montana Commissioner of Securities and Insurance is the state agency responsible for investigating securities fraud and shutting down pyramid schemes. However, current law leaves the Commissioner with few tools to prevent pyramid schemes from taking hold and growing in Montana.

Pyramid Schemes Masquerade as Multi-Level Marketers

Pyramid schemes often mimic the structure of multi-level marketing companies (MLMs) to start recruiting new members. A true MLM, like Avon, Mary Kay, or Tupperware, sells products or services through independent salespeople or contractors. Often MLMs offer a bonus or some other compensation for recruiting new participants, but participants still earn most of their profits through sales.

A pyramid scheme follows the same structure, but flips the compensation structure upside-down. Pyramid scheme participants primarily make money by recruiting new participants, rather than selling products or services. This type of payment structure forces the scheme to keep recruiting members to stay a float and ensures its inevitable collapse.

In the beginning, most pyramid schemes claim to be MLMs. Only after the Commissioner's office has reviewed the scheme's payment structure can the Commissioner take action to shut it down.

A Stronger, Safer MLM Industry

To keep better track of legitimate MLMs in Montana, current law requires MLMs to file a notice with the Commissioner's office before they start recruiting participants in Montana. The law, however, gives the Commissioner no tools to enforce that law. As a result, the Commissioner must wait for a consumer to complain about a potential pyramid scheme before initiating an investigation, and if appropriate, taking legal action.

With the Commissioner's proposed amendment, Senate Bill 20 is a partnership between the Commissioner's office and the MLM industry to create basic enforcement tools for Montana's MLM registration requirement. SB 20 will no longer allow pyramid schemes to hide behind the guise of a legitimate MLM, stopping pyramid schemes before they take hold and promoting a stronger, safer MLM industry in Montana.

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Pyramid Scheme Prevention

SB 20 • Frequently Asked Questions

What is a pyramid scheme?

Pyramid schemes operate on the principle that each member of a group will receive a profit or a cut for recruiting new members to buy into the scheme. Participants have to recruit others into the scheme to make money. As more and more participants join, it becomes harder to find the new recruits necessary to ensure current participants can be paid. The pyramid eventually collapses because participants exhaust the pool of potential people available and willing to join. Pyramid schemes are illegal in Montana.

What is a Multilevel Marketing Company?

Multi-level marketing companies (MLM), also known as multilevel distribution companies, sell, distribute, or supply goods or services through independent agents or contractors at different levels of distribution. Avon, Mary Kay, Amway and Tupperware are all well-known MLMs.

Legitimate MLMs often offer some kind of benefit to participants for recruiting new members. The key difference between a legitimate MLM and pyramid scheme is how participants earn their profits. When participants primarily make money by recruiting rather than selling a product or service, the company isn't an MLM, but a pyramid scheme.

What does SB 20 do?

SB 20 will protect consumers from pyramid schemes while ensuring MLMs can thrive on a level playing field. Current law requires the MLMs to give notice to the Commissioner's office before recruiting participants in Montana. This bill proposes a change in the law to require MLMs pay a fee and register with the CSI. Approval of an MLM registration would be contingent upon the MLM meeting established criteria. The bill also provides a penalty section for MLMs that fail to properly register before obtaining Montana participants.

With the Commissioner's proposed amendment, the registration requirement and fee would not apply to MLMs that are members of the Direct Selling Association. To become a member of the Direct Selling Association, MLMs must pass a rigorous examination and abide by a detailed code of ethics.

What happens if SB 20 isn't passed?

MLMs would still have a legal obligation to notify the Commissioner's office of their intent to recruit member in Montana, but without the enforcement tools included in SB 20, the Commissioner's office has no way to penalize companies that ignore that obligation. Furthermore, the Commissioner's office would still have no way to proactively stop pyramid schemes from taking hold in Montana and causing considerable financial harm to Montanans.

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SB 20 · Section-by-Section Summary

Section 1 Registration requirements for multilevel distribution companies

Multi-level-marketing (MLM) companies currently file with the Commissioner an annual notice of activity (30-10-326, MCA). This notice informs the Commissioner that the MLM operates within Montana. However, the Commissioner has no authority to approve or deny the operation of an MLM within Montana. Section 1 requires MLMs wishing to operate in Montana to register with the Commissioner and grants the Commissioner authority to approve or deny the registration application. These registration requirements mirror those for securities entities and professionals under Section 30-10-201, MCA.

Section 2 Amends Section 30-10-209, MCA

This section requires MLMs to pay an annual registration fee of \$200. Annual registration fees are consistent with the treatment of securities entities and professionals.

Section 3 Amends Section 30-10-301, MCA

This section prohibits an MLM or a person controlling an MLM from engaging in fraudulent and/or misleading business practices.

Section 4 Amends Section 30-10-303, MCA

This section clarifies that an MLM registration or application for registration does not constitute a finding by the Commissioner that the application is true, complete, and not misleading, and does not mean that the Commissioner has made certain determinations regarding the MLM. It also prohibits the making of representations to the contrary.

Section 5 Amends Section 30-10-324, MCA

Subsection 1 restates the Code sections to which the definitions apply. Subsection 2 modifies the definition of "multilevel distribution company" to include those insurance producers, real estate brokers, and securities-related practitioners who are otherwise operating as a multilevel distribution company. This eliminates a loophole whereby individuals in certain professions could bypass the requirements applicable to MLMs. The amendment does not automatically classify all these professionals as multilevel distribution companies -- only those who are also engaging in those other activities included in the definition. Subsection 3 clarifies what items an MLM participant wishing to cancel participation must return to the MLM. Subsection 4 defines "transacting business," a term used in Section 3 to identify the circumstances under which the Section 3 prohibitions apply.

Section 6 Amends Section 30-10-1004, MCA

This section clarifies that the Securities Restitution Assistance Fund may include monies received from persons who violate MLM provisions.

Section 7 Repeals 30-10-326, MCA

This section repeals the current requirement that MLMs file annual notices of activity. This Section is effectively replaced by the registration requirements of Section 1.

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CSI's Proposed Amendment

The Commissioner has negotiated an amendment with the MLM industry association, the Direct Selling Association. The proposed amendment would add an exemption from the registration and fee for any MLM that is a member of the Direct Selling Association.

The Direct Selling Association has a rigorous application and renewal process designed to prevent illegitimate MLMs from becoming members of the association. In fact, the Association's vetting is more in depth than the process prescribed in SB 20. Exempting the Direct Selling Association from the registration and fee preserves the self-policing efforts of the MLM industry while maintaining the enhanced consumer protections sought through SB 20.

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